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# The Last of its Kind: The Review of the Technology Transfer Block Exemption Regulation

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## I. INTRODUCTION

The Technology Transfer Block Exemption, Regulation 240/96 ("TTBE"),<sup>1</sup> which sets out the E.U. competition rules applicable to patent and know-how licensing agreements, was described by Alexander Schaub, former Director General of the European Commission's DG Competition, as a "dinosaur awaiting extinction."<sup>2</sup>

The TTBE is the last of the mainstream E.U. block exemption regulations to apply a formalistic and rigid exemption approach according to which all restraints are presumed to be illegal unless expressly permitted by the block exemption or notified to the Commission for individual clearance. Arbitrary duration limits on the grant of territorial exclusivity, uncertainty as to whether licenses without territorial exclusivity are covered, and the prohibition of non-compete, tying and certain grant back clauses, are just a few examples of the limitations of the TTBE.

In December 2001, the Commission published an Evaluation Report<sup>3</sup> in which it openly admitted the shortcomings of the current TTBE and promised a radical, more liberal, economics-based approach to technology

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<sup>1</sup> Commission Regulation 240/96 on the Application of Article 85(3) of the Treaty to Certain Categories of Technology Transfer Agreements, 1996 O.J. (L 31) 2 [hereinafter TTBE].

<sup>2</sup> Alexander Schaub, Remarks at the Fordham Corporate Law Institute's 28<sup>th</sup> Annual Conference on International Antitrust Law and Policy (Oct. 2001).

<sup>3</sup> Commission Evaluation Report on the Transfer of Technology Block Exemption Regulation No. 240/96: Technology Transfer Agreements Under Article 81 (Dec. 2001), available at [http://www.europa.eu.int/comm/competition/antitrust/technology\\_transfer](http://www.europa.eu.int/comm/competition/antitrust/technology_transfer) [hereinafter Evaluation Report].

transfer in line with the recent revisions of other major block exemptions.<sup>4</sup>

Nearly two years later, on October 1, 2003, the Commission published a formal proposal for a new technology transfer block exemption ("Draft TTBE") together with detailed draft guidelines ("Draft Guidelines")<sup>5</sup> which explain how the new regulation will be interpreted and how Article 81 will be applied to agreements that fall outside the revised regulation's safe harbor. These proposals unleashed a barrage of criticism from industry and seem likely to result in some amendments to the proposed texts before their adoption in March or April 2004. The new package is due to enter into force on May 1, 2004.

Although the TTBE is not due to expire until March 31, 2006, this precipitated review process is designed to coincide with the entry into force on May 1, 2004, of Regulation 1/2003.<sup>6</sup> Regulation 1/2003 will radically reform the system of competition law enforcement in Europe by abandoning the Commission's long-standing monopoly on granting exemption pursuant to Article 81(3) and encouraging a network of national competition authorities and courts in an extended European Union of 25 Member States to apply the E.U. competition rules directly and in their entirety. This broader reform means that where an agreement falls outside a block exemption it is no longer possible to notify the agreement to the Commission for individual exemption to ensure its enforceability. Instead, parties will have to continuously assess whether their agreement still satisfies the cumulative exemption criteria set out in Article 81(3) of the EC Treaty, an exercise fraught with inherent uncertainty.

It is against this background that the Commission's TTBE proposals of October 2003 have been criticized as too rigid and difficult to apply in practice.

After a brief introduction to the current TTBE, this article discusses the Commission's proposals for reform as published in October 2003. We indicate the major changes that are likely to be introduced to this package as envisaged in a revised text circulated by the Commission to the Member States in January 2004 but which, regrettably, will not be made publicly

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<sup>4</sup> See Commission Regulation 2790/1999 on the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices, 1999 O.J. (L 336) 21; Commission Regulation 2658/2000 on the Application of Article 81(3) of the Treaty to Categories of Specialization Agreements, 2000 O.J. (L 304) 3; Commission Regulation 2659/2000 on the Application of Article 81(3) of the Treaty to Categories of Research and Development Agreements, 2000 O.J. (L 304) 7.

<sup>5</sup> Draft Commission Regulation on the Application of Article 81(3) of the Treaty to Categories of Technology Transfer Agreements, 2003 O.J. (C 235) 11 [hereinafter Draft TTBE]; Draft Guidelines on the Application of Article 81 of the EC Treaty to Technology Transfer Agreements, 2003 O.J. (C 235) 17 [hereinafter Draft Guidelines].

<sup>6</sup> Council Regulation 1/2003 on the Implementation of the Rules on Competition Laid Down in Articles 81 and 82 of the Treaty, 2003 O.J. (L 1) 1.

available for further consultation. Although the final package may be subject to further amendment before it is finally adopted, it is encouraging that the Commission seems to have taken on board many of the industry's concerns and is currently envisaging a more flexible regulatory environment than was originally foreseen.

## II. GENERAL BACKGROUND

Article 81(1) of the EC Treaty prohibits all agreements between companies which have as their object or effect the restriction, prevention or distortion of competition within the European Union and which are capable of appreciably affecting trade between E.U. Member States. Restrictive agreements within the meaning of Article 81(1) are automatically void, and therefore unenforceable, by virtue of Article 81(2), subject only to national principles of severability. Infringements of Article 81(1) of the EC Treaty may also result in the imposition of fines of up to ten percent of a company's worldwide aggregate annual turnover and, in certain circumstances, private actions for damages by those who consider that they have been harmed by the anti-competitive agreement.

The prohibition contained in Article 81(1) of the EC Treaty is not absolute. Restrictive agreements will be valid and enforceable if they satisfy the exemption criteria of Article 81(3) of the EC Treaty. An exemption under Article 81(3) of the EC Treaty will be granted if, broadly speaking, the pro-competitive advantages of an agreement outweigh its anti-competitive effects.

Compliance with the conditions set out in a Commission block exemption regulation means that an agreement will automatically be deemed to satisfy the Article 81(3) criteria and thus is exempt from the Article 81(1) prohibition. The benefit of a block exemption may be withdrawal from a specific agreement or category of agreements where there is insufficient competition in a market, but withdrawal is not retroactive and has not occurred to date.

Since the Commission is not only abolishing the individual exemption procedure as part of its Regulation 1/2003 modernization drive, but is also proposing a much stricter approach as to how the new network of enforcement authorities should interpret Article 81(3),<sup>7</sup> companies are likely to increasingly rely on the block exemption safe harbors as a guarantee of legal certainty.

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<sup>7</sup> See Commission Draft Guidelines on the Application of Article 81(3) of the Treaty, 2003 O.J. (C 243) 62. As currently drafted, these Guidelines will impose a much higher, and in the authors' view, unrealistic burden of proof on companies seeking to rely on Article 81(3) by essentially requiring them to substantiate and quantify objective efficiencies likely to arise from their agreement and to demonstrate consumer pass-on benefits.

### III. SCOPE OF THE CURRENT TTBE

The TTBE covers two-party patent and/or know-how license agreements, “in particular” for purposes of manufacturing, use or putting on the market.<sup>8</sup> Agreements licensing intellectual property (“IP”) rights other than patents or know-how (in particular, trademarks, design rights and copyright including software protection) cannot benefit from the current TTBE unless those rights are ancillary to the main patent/know-how license. Agreements which have as their main object the sale or purchase of goods are not covered by the TTBE but are dealt with under the vertical regime.<sup>9</sup>

The TTBE contains a detailed list of white clauses (i.e., unconditionally exempted/permitted clauses, most of which usually do not violate Article 81(1) of the EC Treaty), black clauses (i.e., prohibited clauses, the inclusion of which brings the entire agreement outside the scope of the block exemption) and gray clauses (i.e., potentially exemptible clauses but which require a case-by-case analysis). For the latter category, the TTBE provides for an “opposition procedure” whereby if the Commission does not oppose the application of the block exemption within a period of four months after the clauses in question have been notified to it, the TTBE is deemed to apply. Restrictions not expressly covered by either the white or black list are treated as “gray” clauses.

The TTBE only applies to those patent/know-how license agreements which contain one or more of the obligations listed in Article 1(1). The first six of these obligations involve territorial limitations on the license being granted and exclusivity as between the licensor and licensee and/or between licensees. Unless the agreement provides for an obligation on the licensee to use only the licensor’s trademark<sup>10</sup> or an output limitation to only manufacture the licensed products for the licensee’s own products,<sup>11</sup> the inclusion of such restraints is required to ensure the availability of the block exemption in the first place. While the type of licenses to which the TTBE applies includes those containing “*obligations of the types referred to in [Article 1(1)] but with a more limited scope than is permitted by [it]*,”<sup>12</sup> it has never been clear whether this would be sufficient for the TTBE to apply if none of the obligations in Article 1 is expressly included in the agreement. This has had the counterintuitive effect of ensuring that licenses contain territorial restrictions regardless of whether this was a commercial priority of either the licensor or licensee.

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<sup>8</sup> TTBE, *supra* note 1, at recital 5.

<sup>9</sup> See Regulation 2790 on the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices, *supra* note 4.

<sup>10</sup> TTBE, *supra* note 1, at art. 1(1)(7).

<sup>11</sup> *Id.* at art. 1(1)(8).

<sup>12</sup> *Id.* at art. 1(5) (emphasis added).

Another major weakness is the imposition of arbitrary duration limits. Territorial exclusivity is permitted in a pure patent license only for as long as parallel patents remain in force in the territories concerned.<sup>13</sup> Territorial exclusivity in a pure know-how license is permitted only for a period of ten years from the first sale of the product in question in the European Union by any licensee, regardless of whether the know-how remains secret and valuable thereafter or has been complemented by additional know-how in the interim.<sup>14</sup>

The current TTBE does not distinguish between agreements concluded between competitors or non-competitors: both are assessed according to the same lists of white, black<sup>15</sup> and gray clauses. Market shares of the contract parties are relevant only in the context of joint venture agreements<sup>16</sup> and to the extent that the Commission can, in theory, withdraw the benefit of the block exemption where the licensee's market share exceeds forty percent.<sup>17</sup>

#### IV. OVERVIEW OF THE DRAFT TTBE

##### A. Revised Exemption Scheme

In line with the Commission's general policy of introducing more economic analysis when applying the block exemption regulations, the Draft TTBE follows the modern and less formalistic "umbrella style" exemption scheme according to which, within certain market share thresholds, all restraints which are not expressly prohibited are permitted.<sup>18</sup>

Instead of the detailed catalogues of white, black and gray clauses, the Draft TTBE contains a shortened list of stringently prohibited restrictions, the inclusion of which brings the entire agreement outside the scope of the block exemption. The Draft TTBE also provides for a limited list of restraints which are not covered by the block exemption, but which do not affect its applicability to the remainder of the agreement. The opposition

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<sup>13</sup> *Id.* at art. 1(2).

<sup>14</sup> *Id.* at art. 1(3).

<sup>15</sup> Except that customer restrictions in licenses between competitors are prohibited.

<sup>16</sup> See TTBE, *supra* note 1, at art. 5(2)(1) (restricting the block exemption when technology transfer agreements are made between a parent entity and a joint venture to cases in which the participating companies do not exceed a twenty percent market-share threshold in the case of a license limited to production, or a ten percent market-share threshold in the case of a license covering production and distribution).

<sup>17</sup> *Id.* at art. 7(1).

<sup>18</sup> For example, under this new approach tying and non-compete clauses in relation to distribution activities are no longer expressly mentioned by the Draft TTBE and will thus be exempted within the respective market-share thresholds. The current TTBE does not exempt such clauses. See *id.* at art. 4(2) (treating tying clauses as gray clauses); *id.* at art. 3(2) (black-listing non-compete clauses).

procedure will be abolished.

The new approach is characterized by two major structural changes with far-reaching practical consequences: (i) the distinction between agreements between competitors, and agreements between non-competitors, and (ii) the introduction of market share thresholds.

*1. Distinction between Agreements between Competitors and Non-Competitors*

This distinction is of significant practical importance for the structuring of licensing agreements. As explained below, restraints in agreements between competitors will be subject to lower market share thresholds and a longer list of hardcore restrictions, while agreements between non-competitors will be treated more leniently.

In assessing the competitive relationship between the parties to a licensing agreement, it will be necessary to examine two markets: the product market and the technology market. In the relevant product market, the question is the traditional one as to whether the parties are actual or realistic potential competitors. A welcome, more practical approach is proposed in relation to the relevant technology market where the Commission will only examine whether the parties are *actual* competitors, *i.e.*, whether they actually license competing technologies. In calculating the licensor's share of the relevant technology market, the Commission will look at the share that the technology represents of the downstream product market (taking into account the combined production of the licensor and its licensees) rather than trying to calculate the licensor's royalty income on the relevant technology licensing market.<sup>19</sup>

The Commission helpfully states in its Draft Guidelines that parties will not be considered to be competitors if their technologies are in a one-way or two-way blocking position. However, such a finding will require "[p]articularly convincing evidence" that a blocking position exists such as a final court decision on the matter or the opinion of independent experts.<sup>20</sup> The implication that companies should choose to litigate rather than settle in order to benefit from the more liberal rules applied to non-competitors has been criticized as unrealistic and unnecessarily formalistic, especially for certain industrial sectors including IT and pharmaceuticals where such disputes are frequent occurrences. The Commission has indicated in January 2004 that it may be prepared to accept other "convincing" evidence, including expert evidence from the parties themselves.

In its 2001 Evaluation Report, the Commission suggested that where one competitor introduces a "drastic innovation" to the market (*e.g.*, the CD

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<sup>19</sup> Draft TTBE, *supra* note 5, at art. 3(3).

<sup>20</sup> Draft Guidelines, *supra* note 5, at para. 25.

player replacing the LP technology), the innovator's licenses of the breakthrough technology to its existing competitors would benefit from the more liberal regime applicable to non-competitors.<sup>21</sup> However, at Paragraph 26 of the Draft Guidelines, the Commission states that, at the time of the license, it is often not possible to conclude that the new technology already constitutes a separate new market: any such development can usually only be concluded from an *ex post* perspective. This would mean that in order to benefit from the block exemption, the parties would be constrained at the outset by the considerably stricter rules governing agreements between competitors, but could at some point in the future adapt their license to reflect the more generous rules applicable to non-competitors. In the authors' view, if the parties reasonably believed at the outset that the licensed technology was likely to amount to a "drastic innovation" in the short-term and chose to avail themselves of some of the restrictions that are only permitted in agreements between non-competitors, they should not be unduly penalized by a competition authority subsequently substituting its own *ex post* assessment for the parties' good faith *ex ante* judgment.

As of January 2004, the Commission appears willing to accept that where parties become competitors after the conclusion of the agreement because, for example the licensee goes on to develop a competing technology, the stricter rules governing relationships between competitors will not be applied unless the agreement is subsequently altered or amended.

## 2. Introduction of Market-Share Thresholds

One of the more controversial aspects of the Commission's proposals is the introduction of market share thresholds. The Draft TTBE will apply to agreements between competitors where their combined market share either on a relevant technology or on a relevant product market does not exceed twenty percent.<sup>22</sup> At only twice the *de-minimis* level,<sup>23</sup> this will mean that many existing agreements between competitors will no longer be covered by the revised TTBE. Non-competing parties will benefit from the revised Regulation if they *each* have a share not exceeding thirty percent in the relevant technology and product markets.<sup>24</sup> If the parties initially fall under the block exemption regulation but later exceed the market share thresholds, they will retain the benefit of a block exemption for another two

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<sup>21</sup> Evaluation Report, *supra* note 3, at para. 125.

<sup>22</sup> Draft TTBE, *supra* note 5, at art. 3(1).

<sup>23</sup> Commission Notice on Agreements of Minor Importance which do not Appreciably Restrict Competition under Article 81(1) of the Treaty, 2001 O.J. (C 368) 13.

<sup>24</sup> Draft TTBE, *supra* note 5, at art. 3(2).



years.<sup>25</sup>

While the introduction of market shares is in line with the Commission's approach to introduce more economic criteria to the application of block exemption regulations generally, in the context of licensing agreements, market share thresholds can be notoriously difficult to apply in practice.

Market shares are often an inappropriate and somewhat arbitrary indicator of the competitive situation and future dynamics of innovative markets: apart from the difficulties inherent defining the appropriate relevant markets, in particular with respect to new technologies, market shares cannot appropriately reflect future developments and in particular the significant impact of potential competition. In January 2004, the Commission has somewhat helpfully indicated that outside the block exemption safe harbor, it will normally take the view that in the absence of hardcore restrictions, Article 81 is unlikely to be infringed where there exist four or more independently controlled technologies that may be substitutable for the licensed technology at a comparable cost to the user.

In this regard, the U.S. approach as reflected in the Federal Trade Commission's 1995 Antitrust Guidelines for the Licensing of Intellectual Property, which focuses on the remaining independent poles of research as opposed to readily available substitutes, seems more appropriate.

Industry representatives have vociferously objected to the Commission's plans to subject agreements between non-competing parties to a requirement that they each have a market share not exceeding thirty percent. If a right holder has the right not to license its technology in the first place, then limited licenses should generally be acceptable absent significant market power and very particular circumstances which clearly indicate that a given license is appreciably reducing competition in the market: the withdrawal mechanism and Article 82 of the EC Treaty which prohibits the abuse of dominance ought to be sufficient to cover such eventualities. The Commission, however, seems unlikely to waver on this issue.

### B. Broader Scope of the Draft TTBE

The scope of the new Regulation will be broader than the current TTBE in that it will cover not only patent and/or know-how licensing agreements, but also software copyright licensing agreements.<sup>26</sup> There is a proviso that the primary object of any license agreement should relate to the manufacture or provision of the contract products/services. It is unclear how the Commission will interpret the "manufacturing" requirement in the

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<sup>25</sup> *Id.* at art. 8(2).

<sup>26</sup> *Id.* at art. 1(b).

context of software agreements. A narrow interpretation could potentially exclude a large number of software agreements from the block exemption, such as word processing software used by professionals or utilization restraints in the form of CPU, upgrade or original equipment manufacturer (“OEM”) clauses. The Draft TTBE does not provide for the inclusion of other IP rights such as trademarks: they will be covered by the Draft TTBE only to the extent that they are ancillary to the primary object of the agreement and are directly related to the manufacture or provision of the contract products.<sup>27</sup>

In its Draft Guidelines, the Commission is proposing to exclude non-assertion and settlement agreements from the scope of the revised Regulation on the grounds that their primary object is not the manufacture/provision of products.<sup>28</sup> This carve-out is particularly unfortunate in those sectors where patent thickets are common. Non-assertion and settlement agreements allow companies to carry on their business in the knowledge that their investments will not be threatened by litigation. There is no obvious reason to exclude them from the block exemption safe harbor. The Commission seems to have accepted this view and, as of January 2004, is prepared to include in the TTBE safe harbor non-assertion and settlement agreements whereby the licensor permits the licensee to produce within the scope of its patent.

There are a number of other limitations on the scope of the Draft TTBE. For example, the definition of “know-how”<sup>29</sup> requires that the know-how be “indispensable” for the manufacture/provision of the contract products. The current TTBE merely requires that the know-how be “useful.”<sup>30</sup> The Commission has since indicated that it is prepared to revert to this lower “useful” standard.

Also, the Draft Guidelines would exclude from the new rules technology licensed for the purposes of enabling the licensee to carry out research and development (“R&D”) for his own account for later exploitation.<sup>31</sup> It is not clear why such arrangements should be excluded if they are designed to assist the licensee in bringing new products to the market, for as long as they fall outside the ambit of the Commission’s R&D block exemption. As of January 2004, the Commission seems willing to accept that the Draft TTBE should also apply to agreements whereby the licensee must carry out further development before obtaining a product or process that is ready for commercial exploitation, for as long as a contract product has been identified up-front.

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<sup>27</sup> *Id* at art. 1(b).

<sup>28</sup> Draft Guidelines, *supra* note 5, at para. 35.

<sup>29</sup> Draft TTBE, *supra* note 5, at art. 1(g).

<sup>30</sup> TTBE, *supra* note 1, at art. 10(3).

<sup>31</sup> Draft Guidelines, *supra* note 5, at para. 41.

### C. Hardcore Restraints under the Draft TTBE

Article 4 of the Draft TTBE contains an extensive list of prohibited restraints the inclusion of which will take the entire agreement outside the safe harbor.

#### 1. *Hardcore Restraints in Agreements between Competitors*

##### a. Price-Fixing (Draft TTBE, Article 4(1)(a))

Article 4(1)(a) of the Draft TTBE contains an uncontroversial prohibition of downstream price-fixing.<sup>32</sup> However, at Paragraph 77 of the Draft Guidelines, the Commission states that in the context of cross-licensing between competitors, royalty obligations calculated on the basis of individual product sales may amount to price-fixing and thus constitute a hardcore restriction of competition unless the parties can demonstrate that their agreement leads to a “*significant integration of complementary technologies*,” and that they could not have chosen a less restrictive payment scheme such as lump sum payments.<sup>33</sup> This disregards the fact that running royalties are often the only economically feasible way to establish the price for a technology license and thus encourage the dissemination of the technology in the first place, in particular where the commercial success of a technology is unforeseeable at the outset. As of January 2004, the Commission appears willing to accept this reasoning and has indicated that it will be suspicious of running royalties only where the agreement is devoid of any pro-competitive purpose and does not constitute a *bona fide* licensing agreement.

The Commission’s expansive ability to foresee price-fixing continues at Paragraph 199 of the Draft Guidelines where it assumes that royalty and other payment schemes concluded in the context of settlement and non-assertion agreements will encourage price coordination unless such agreements are royalty free or provide for a one-off lump sum royalty.<sup>34</sup> As of January 2004, the Commission seems likely to abandon this approach which would undermine the parties’ ability to settle patent infringement suits where parties are often unable to predict let alone agree on the relative value of their respective rights over time.

##### b. Output Restraints (Draft TTBE, Art 4 (1)(b))

Article 4(1)(b) of the Draft TTBE prohibits “the limitation of output or sales, except limitations on the output of contract products imposed on the

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<sup>32</sup> Draft TTBE, *supra* note 5, at art. 4(1)(a).

<sup>33</sup> *Id.* at para. 77 (emphasis added).

<sup>34</sup> *Id.* at para. 199.

licensee in a non-reciprocal agreement.”<sup>35</sup> This carve-out of non-reciprocal restraints is less helpful than it appears since such restraints are excluded from the scope of the Draft TTBE by virtue of Article 5(2) and fall to be individually assessed in accordance with Article 81(3) of the EC Treaty.

As of January 2004, the Commission seems willing to accept that also output restraints in reciprocal agreements between competitors are block exempted if only imposed on one licensee. It is also proposing to delete Article 5(2) so that such restraints will fall squarely within the block exemption safe harbor.

c. Territorial and Customer Restraints (Draft TTBE, Article 4(1)(c))

Article 4(1)(c) of the Draft TTBE prohibits the allocation of markets or customers between competitors except for:

- (i) an obligation on the licensee in a non-reciprocal agreement to exploit the licensed technology only within one or more technical fields of use of one or more product markets, or
- (ii) a requirement that the licensee manufactures or provides the contract products only for its own use.<sup>36</sup>

Under the Draft TTBE, therefore, all territorial restraints in agreements between competitors which restrict the freedom of the licensor will hence be considered as hardcore violations of Article 81(1). Only sole licenses where the licensor remains free to use but agrees to grant no other licenses are covered by the block exemption. This is a drastic change with far-reaching consequences for existing agreements between competitors: under the existing TTBE, territorial restraints binding both licensor and licensee are commonplace. At Paragraph 80 of the Draft Guidelines, the Commission argues that it is not appropriate to block exempt output restrictions on the licensor on the basis that “when a licensee is willing to accept a one way restriction, it is likely that the agreement leads to a real integration of complementary technologies or an efficiency enhancing integration of the licensor’s superior technology with the licensee’s product assets.” Arguably, there is no reason to prohibit output restraints on the licensor provided the licensee is free to exploit its own technology without limitation. The proposed approach would prevent the licensor from agreeing not to use its own technology in a territory or field of use granted to the licensee.

Similarly, provided the parties are free to use their existing technology, reciprocal field of use restraints between competitors may not be restrictive and indeed may be necessary to encourage licensing in the first place. Field of use restrictions usually reflect the different technological focus of the

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<sup>35</sup> Draft TTBE, *supra* note 5, at art. 4(1)(b).

<sup>36</sup> *Id.* at art. 4(1)(c).

parties, but they may also be agreed on for monetary reasons where one party is not prepared to compensate the other for the technology covering a broad field of application. Reciprocal field of use restraints are frequently used to settle patent litigation. It therefore appears overly severe to consider reciprocal field of use restrictions as per se illegal, particularly if there is sufficient inter-brand competition in the market.

As of January 2004, the Commission has apparently accepted that the hardcore list in relation to field-of-use, territorial, and customer restraints was too rigid and seems prepared to introduce significant changes by permitting both field-of-use restraints in cross licensing between competitors, as well as a field-of-use restraint on the licensor where exclusivity in the field is granted to the licensee and territorial and customer restrictions agreed between licensor and licensee in a non-reciprocal agreement. This will allow the parties to allocate exclusive territories between them and restrict active and passive sales into each others' territories. In addition, the revised proposal exempts the restriction of active sales into exclusively allocated territories of other licensees.

d. Restraints on R&D and the Exploitation of Own Technologies (Draft TTBE, Article 4(1)(d))

Article 4(1)(d) of the Draft TTBE prohibits any restriction on the licensee's ability to exploit its own technology or the restriction of the ability of either party to carry out independent R&D unless this restraint is "indispensable" to prevent the disclosure of licensed know-how to third parties.<sup>37</sup> The proposed changes lead to more flexibility than currently provided for under the existing TTBE, according to which all non-compete obligations are considered hardcore restraints regardless of whether they relate to distribution, production or R&D activities.<sup>38</sup> Under the Draft TTBE, restraints on the licensee's ability to exploit competing third party technologies would now be exempted below the market share threshold of twenty percent.

2. *Hardcore Restraints in Agreements between Non-Competitors*

a. Price Fixing (Draft TTBE, Article 4(2)(a))

Article 4(2)(a) of the Draft TTBE prohibits downstream price-fixing, but, in contrast to the approach adopted in relation to agreements between competitors, it expressly permits the licensor to impose maximum sales prices or recommended sales prices.<sup>39</sup>

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<sup>37</sup> *Id.* at art. 4(1)(d).

<sup>38</sup> TTBE, *supra* note 1, at art. 3(2).

<sup>39</sup> Draft TTBE, *supra* note 5, at art. 4(2)(a).

b. Territorial and Customer Restraints (Draft TTBE, Article 4(2)(b))

Article 4(2)(b) prohibits restrictions of the territory into which or of the customers to whom, the licensee may sell, except:

- (i) sales where the territory/customer group is exclusively reserved to the licensor;
- (ii) active sales into territories/customer groups which are exclusively reserved to another licensee;
- (iii) a requirement that the licensee manufactures or provides the contract products only for its own use;
- (iv) restrictions of sales to end users by a licensee operating the wholesale level; and
- (v) restrictions of sales to unauthorized distributors by the members of a selective distribution system.<sup>40</sup>

Article 4(2) of the Draft TTBE follows the Commission's approach regarding the assessment of territorial and customer restraints<sup>41</sup> under the vertical restraints block exemption, with the exception that the licensor can prevent its licensees from actively but also from *passively* selling into territories/customer groups reserved exclusively for sales by the licensor.<sup>42</sup>

The current TTBE permits restraints on passive sales to territories of other licensees for a period of five years from first introducing the product on the market.<sup>43</sup> According to the Draft TTBE, active, but not passive sales, can be restricted amongst licensees who have been awarded exclusive territories/customer groups.<sup>44</sup> However, Paragraph 93 of the Draft Guidelines recognizes that passive sales restrictions for two years from when the contract product incorporating the licensed technology is first put on the market often fall outside the scope of Article 81(1) of the EC Treaty in the first place as a necessary incentive for the licensee to take on the often substantial risks and investments associated with the license. It is misleading that the Draft TTBE blacklists a clause that for this two year period is assumed not to infringe Article 81(1) of the EC Treaty.

As of January 2004, the Commission seems to be prepared to

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<sup>40</sup> *Id.* art. 4(2)(b).

<sup>41</sup> Customer restraints in agreements between non-competitors are treated as gray clauses under the current TTBE which means that they benefit from the block exemption only after notification under the opposition procedure. *Id.* at recital 23; Evaluation Report, *supra* note 3, at para. 19.

<sup>42</sup> Draft TTBE, *supra* note 5, at art., 4(2)(b)(i). The Draft TTBE does not define active and passive sales. However, according to Paragraph 50 of the Guidelines on Vertical Agreements, *active* sales mean "actively approaching customers inside another distributor's exclusive territory or exclusive customer group" and *passive* sales mean "responding to unsolicited request from individual customers."

<sup>43</sup> TTBE, *supra* note 1, at art. 1(1)(6), 1(3).

<sup>44</sup> Draft TTBE, *supra* note 5, at art. 4(2)(b)(ii).

expressly block exempt all restrictions on active and passive sales imposed on the licensor, all active sales restrictions imposed on the licensee, and passive sales by licensees into the exclusive territory or to the exclusive customer group allocated to another licensee for a period of two years.

c. Customer Restraints in Selective Distribution Systems (Draft TTBE, Article 4(2)(c))

In agreements between non-competitors, Article 4(2)(c) of the Draft TTBE prohibits restrictions on sales to end users by licensees which are members of a selective distribution system operating at the retail level.<sup>45</sup> However, location clauses are permitted: the licensor may prohibit its licensees from operating out of an unauthorized place of establishment. This hardcore restraint mirrors Article 4(c) of the vertical restraints block exemption. Selective distribution systems are not expressly mentioned in the current TTBE.

D. Other Significant Changes

1. *Longer Duration*

The draft Regulation will apply for as long as the last intellectual property right remains valid.<sup>46</sup> This is a significant improvement over the arbitrary duration limits in the current TTBE.

2. *Multi-Party Agreements Excluded*

Extending the scope of the block exemption to cover agreements between more than two parties would have required the Council of Ministers to amend Regulation 19/65 which allows the Commission to implement Article 81(3), a step which the Commission chose to avoid in its rush to have the new rules in place by May 2004.<sup>47</sup> Against the backdrop of the modernization experiment, it is unfortunate that multiparty agreements will be excluded from the revised block exemption safe harbor. However, in assessing multiparty agreements the Commission states that it will apply the principles set out in the Draft TTBE by analogy.<sup>48</sup>

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<sup>45</sup> *Id.* at art. 4(2)(c).

<sup>46</sup> *Id.* at art. 2.

<sup>47</sup> Council Regulation 19/65 (EEC) of 2 March 1965 on the Application of Article 85(3) of the Treaty to Certain Categories of Agreements and Concerted Practices, 1965 O.J. (L 36) 533.

<sup>48</sup> Draft Guidelines, *supra* note 5, at para. 33.

### 3. Subcontracting

Paragraphs 37-40 of the Draft Guidelines purport to replace the Commission's 1979 Notice on Subcontracting.<sup>49</sup> The Commission is likely to abandon this approach and instead complement the 1979 Notice since the latter covers situations outside the scope of the Draft TTBE such as subcontracting involving only the transfer of equipment.

In assessing subcontracting agreements in the future, it will be necessary to look at the Draft Guidelines, the specialization block exemption<sup>50</sup> and the Commission's vertical and horizontal guidelines, as well as the 1979 Notice.<sup>51</sup> In light of the significance of outsourcing in today's economy, it would be helpful for the Commission to consolidate its approach to subcontracting in one policy document.

### 4. Technology Pools

Technology pools, whereby two or more parties combine technologies in a package which is licensed to members of the pool and to third parties, are not covered by the Draft TTBE, but are discussed in some detail in the Draft Guidelines. Although the pool itself is outside the scope of the draft regulation, because its main aim is not the manufacture of contract products, individual licenses granted by the pool to third party licensees are covered.

In short, the Commission indicates that the pooling of complementary technologies will be viewed more favorably than the pooling of technological substitutes (which is viewed as collective tying and is therefore unlikely to be exempted).

The Commission also distinguishes between essential and non-essential technologies. The pooling of essential technologies is likely to fall outside the scope of Article 81(1) of the EC Treaty in the first place. The inclusion of non-essential technologies will bring a pool within Article 81(1) of the EC Treaty and will be assessed on its merits. In this respect, the Draft Guidelines go further than Commission case law to date and introduce welcome flexibility. In its assessment of such agreements, the Commission will examine, *inter alia*, how the pool is structured, whether safeguards exist to prevent the exchange of sensitive pricing and output data, whether an independent dispute resolution mechanism is in place, etc.

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<sup>49</sup> Commission Notice concerning the assessment of certain subcontracting agreements in relation of Article 81 (1) of the Treaty, 1979 O.J. (C 1) 2.

<sup>50</sup> Commission Regulation (EC) 2685/2000 of 21 November 2000 on the Application of Article 81(3) of the Treaty to Categories of Specialization Agreements, 2000 O.J. (L 304) 3.

<sup>51</sup> Paragraph 33 Guidelines on Vertical Restraints; Draft Guidelines, *supra* note 5, at para. 81.



### 5. *The Transitional Period*

Article 9(2) of the Draft TTBE envisages that agreements which qualify under the current TTBE, which was to have remained in force until March 31, 2006, will benefit from transitional relief only until October 31, 2005.<sup>52</sup> Given the drastic changes envisioned in the approach to agreements between competitors,<sup>53</sup> it has been argued that this transitional period undermines legal certainty by shortening an existing block exemption. Restrictions which have to date been covered by the current TTBE would, upon expiration of the proposed transition period, qualify as hardcore restraints under the new proposal. As of January 2004, it appears that the Commission is willing to extend the transition period to March 31, 2006.

## V. RESTRAINTS OUTSIDE THE SAFE HARBOR TO BE INDIVIDUALLY ASSESSED UNDER ARTICLE 81(3)

### A. Grant-backs, Assignment Obligations and No-Challenge clauses (Draft TTBE, Article 5(1))

Article 5(1) of the Draft TTBE takes outside the scope of the block exemption safe harbor:

- (i) a requirement on the licensee to exclusively license its severable improvements to the licensor;
- (ii) a requirement on the licensee to assign improvements to the licensor; and
- (iii) a no-challenge clause without prejudice to the licensor's right to terminate the license in the event the licensee challenges the validity of the licensed intellectual property rights.<sup>54</sup>

Under the current TTBE, grant-back provisions are permissible only if they are non-exclusive and reciprocal. Under the new proposal, non-reciprocal grant back obligations, whether imposed on the licensee or licensor would be covered by the Draft TTBE, for as long as the grant-back is non-exclusive.

With respect to the assignment of improvements<sup>55</sup> and no-challenge clauses,<sup>56</sup> under the current TTBE both clauses are black listed hardcore restraints, the inclusion of which renders the block exemption inapplicable to the entire agreement. The new proposal is welcome in that it will take these restraints outside the scope of the block exemption, however, without affecting the validity of the remainder of the agreement. As of January

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<sup>52</sup> Draft TTBE, *supra* note 5, at art. 9(2).

<sup>53</sup> See *infra* § IV(C)(1).

<sup>54</sup> Draft TTBE, *supra* note 5, at art. 5(1).

<sup>55</sup> *Id.* at art. 5(1)(b).

<sup>56</sup> *Id.* at art. 5(2)(c).

2004, the Commission seems willing to limit the scope of Article 5(1)(b) so as to include in the safe harbor a requirement on the licensee to assign non-severable improvements to the licensor. As under the current regime, a clause enabling the licensor to terminate the agreement if the licensee challenges the licensed IP rights would be covered by the Draft TTBE.

**B. Restraints on Exploitation of Existing Technologies and on Carrying out of R&D between Non-Competitors (Draft TTBE, Article 5(3))**

By virtue of Article 4(1)(d) of the Draft TTBE, it is prohibited, in agreements between competitors, to restrict the licensee's ability to exploit its own technology or the restriction of the ability of either party to carry out independent R&D unless it is "indispensable" to prevent the disclosure of licensed know-how to third parties.<sup>57</sup> However, by virtue of Article 5(3), in agreements between non-competitors, the inclusion of these restraints does not bring the entire agreement outside the scope of the block exemption but will require them to be analyzed in light of the Article 81(3) exemption criteria.

## VI. CONCLUSION

In line with the Commission's aim of "modernizing" the block exemption regulations in preparation for the decentralized enforcement system created by Regulation 1/2003, a revised TTBE will provide for an "umbrella style" exemption approach according to which, within certain market share thresholds, all restrictive agreements will be allowed unless expressly prohibited. Above the market share thresholds, there is no presumption that an agreement is illegal: the burden of proof that the agreement falls within Article 81(1) falls on the competition authority or plaintiff that seeks to challenge its validity.

Central to the Commission's reform proposals is the sensible distinction between agreements concluded between competitors and agreements concluded between non-competitors. However, the draft texts of October 2003 created the distinct impression that the Commission inherently mistrusts many licensing relationships as thinly disguised market sharing arrangements or as abuses of the underlying patent system. It erred too far on the side of caution in trying to draw a line between the strict minimum necessary to encourage licensors to disseminate their technology and the perceived need to protect intra-technology competition and ensure that licensees become potential sources of innovation. For agreements between competitors, the Draft TTBE's stricter rules with respect to territorial and field of use restraints would have significant implications for a great many existing contracts. In other respects, the new proposals would,

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<sup>57</sup> *Id.* at art. 4(1)(d).

however, introduce greater flexibility: software agreements would be covered, the arbitrary duration limits on the grant of exclusivity would be removed, tying obligations and non-compete obligations would be exempted within the respective market share thresholds, reciprocal grant-back obligations would no longer be required, and welcome guidance is provided on important licensing phenomena such as technology pools.

As the Commission indicated in January 2004, the Commission hopes to maintain its readiness to significantly amend its proposals if the new package is to have the desired effect of providing sufficient legal certainty to promote the dissemination of technology in the European Union.